

LITTER TAX COMPLIANCE

Report of the Department of Revenue

*Prepared Pursuant to
Chapter 257, Laws of 1998 (2SHB 3058)*

**Washington State Department of Revenue
Frederick C. Kiga, Director**

Analysis by the Research Division

January 2001

February 2, 2001

TO: The Honorable Lisa Brown, Chair
Senate Ways and Means Committee

The Honorable Jack Cairnes, Co-Chair
House Finance Committee

The Honorable Jeff Morris, Co-Chair
House Finance Committee

FROM: Frederick C. Kiga, Director

SUBJECT: LITTER TAX COMPLIANCE REPORT

Legislation in 1998 directed the Department to report biennially on litter tax reporting and compliance. This report presents the Department's second response to this requirement.

The 1998 legislation also changed taxpayer reporting of litter tax. Starting in 1999, the tax was reported on each tax return filed by the taxpayer. Previously, litter tax was reported annually while most taxpayers filed monthly or quarterly. The report indicates that the 1998 statutory change had an extremely positive effect on litter tax reporting. The number of filers increased 56 percent in 1999 and total collections reached an all-time high.

Tables in the study also report the following:

- ◆ Tax reported voluntarily vs. tax obtained through enforcement activities,
- ◆ The number of taxpayers and amount of tax paid by major industry, and
- ◆ Total estimated litter tax noncompliance.

We will be distributing copies of the report to the members of your committees and to the Governor and his staff. If you have any questions about the findings, please contact Mary Welsh with our Research Division at 570-6076.

cc: The Honorable Gary Locke, Governor
Cheryl Strange, Department of Ecology

LITTER TAX COMPLIANCE

The 1998 Legislature established a requirement that a report covering litter tax compliance be prepared beginning in 1999 and in odd-numbered years thereafter (Section 7 of 2SHB 3058, codified in RCW 82.19.010(2)). This report is the Department of Revenue's second submission in response to that requirement. In response to a legislative request, an estimate of total litter tax noncompliance has been added this year.

OVERVIEW OF THE LITTER TAX

The litter tax was adopted in 1971 as part of the Model Litter Control and Recycling Act of 1971. The tax is imposed upon manufacturers, wholesalers, and retailers who sell any item from a list of thirteen categories of products. The categories, as listed in RCW 82.19.020, are:

1. Food for human or pet consumption
2. Groceries
3. Cigarettes and tobacco products
4. Soft drinks and carbonated waters
5. Beer and other malt beverages
6. Wine
7. Newspapers and magazines
8. Household paper and paper products
9. Glass containers
10. Metal containers
11. Plastic or fiber containers made of synthetic material
12. Cleaning agents and toiletries
13. Nondrug drugstore sundry products

Taxpayers compute the amount of tax due by multiplying the gross proceeds of sales of the listed items by the tax rate of fifteen one-thousandths of one percent (0.00015). By comparison, this tax rate is only 3 percent of the typical B&O tax rate (0.484 percent for manufacturing/wholesaling), so the amount of tax liability for many firms is quite low.

The tax receipts are devoted to litter-related programs conducted by the Department of Ecology and other state agencies and for grants to local governments for similar programs (Waste Reduction, Recycling and Litter Control Account per RCW 70.93.180).

The Department of Revenue received many complaints from taxpayers regarding the difficulty of sorting through their inventory and sales data to determine which items are included in the list of thirteen taxable products. Certain businesses were relieved of this task by an administrative rule adopted by the Department pursuant to authority granted in the litter tax statutes. The rule, WAC 458-20-243, allows grocery stores and drug stores to report and pay the litter tax measured by a percentage of total sales (95 and 50 percent, respectively).

TABLE 1 – LITTER TAX COMPLIANCE

Table 1 shows litter tax receipts for calendar years 1991–1999. It compares the actual amount of tax reported voluntarily by taxpayers to the amount obtained from Department enforcement activities. Department enforced liability is defined as tax collected through Department enforcement actions or the tax filed on a supplemental return to report the litter tax after the normal due date. Such liability results from assessments (usually in conjunction with a field audit), corrections to the taxpayer's account (usually by an office audit), tax warrants or supplemental returns.

For Calendar 1999, tax from enforcement exceeded \$1 million for the first time. Tax reported voluntarily also reached an all-time high of nearly \$4.5 million. Historically, enforcement activities have accounted for approximately 10 to 20 percent of total litter tax receipts. For 1999, enforcement provided 18.4 percent of total litter receipts.

Table 1
LITTER TAX COMPLIANCE

Tax Reported Voluntarily vs.
Tax Obtained via Enforcement

Estimates for Calendar Years 1991 – 1999
Dollars in Thousands

<u>Year</u>	<u>Total Tax</u>	<u>Tax Reported Voluntarily</u>		<u>Tax from Enforcement*</u>	
		<u>Amount</u>	<u>% of Total</u>	<u>Amount</u>	<u>% of Total</u>
1991	\$3,904.0	\$3,104.8	79.5%	\$799.2	20.5%
1992	3,884.9	3,215.4	82.8	669.5	17.2
1993	3,851.3	3,273.3	85.0	578.0	15.0
1994	4,017.9	3,304.5	82.2	713.4	17.8
1995	4,401.1	3,988.6	90.6	412.5	9.4
1996	4,298.6	3,539.0	82.3	759.6	17.7
1997	4,143.2	3,477.2	83.9	666.0	16.1
1998	4,873.1	4,309.9	88.4	563.2	11.6
1999	5,509.1	4,493.4	81.6	1,015.7	18.4

*Enforcement includes audit assessments, correction to account adjustments, warrants and supplemental returns (due to amnesty program in 1991).

Table 2
LITTER TAX REPORTERS BY YEAR AND INDUSTRY
Includes Voluntary and Involuntary Reporting

Calendar Years 1994 - 1999

SIC GROUP	INDUSTRY DESCRIPTION	1994	1995	1996	1997	1998	1999
1-14	Agricultural and Fishing	344	385	326	293	290	490
15-17	Construction	156	148	124	125	150	662
20	Food and Kindred Products	230	275	243	207	198	235
24,25	Lumber, Wood Products and Furniture	25	29	24	28	20	33
26	Paper and Allied Products	27	34	34	26	32	35
27	Printing and Publishing	330	324	309	257	229	330
28,29	Chemical and Petroleum Mfg.	10	16	15	12	10	17
31,32	Leather, Stone Products	5	4	3	3	2	10
33,34	Primary and Fabricated Metals	11	11	10	13	7	16
35,36	Industrial and Electrical Machinery	8	10	15	16	12	24
37	Transportation Equipment	6	8	6	5	9	27
39	Misc. Manufacturing Industries	7	12	13	14	10	20
41-47	Transportation	54	66	45	53	54	85
49	Electric, Gas, and Sanitary Services	7	6	9	8	7	24
50	Wholesale Trade Durable Goods	223	223	204	192	166	332
51	Wholesale Trade Nondurable Goods	1,758	1,900	1,684	1,487	1,417	1,738
52	Building Materials & Garden Supplies	166	175	154	143	139	200
53	General Merchandise Stores	152	161	141	131	153	190
54	Food Stores	2,923	3,032	2,916	2,628	2,503	3,219
55	Automotive Dealers & Service Stations	548	632	600	584	660	911
56	Apparel and Accessory Stores	42	42	30	39	40	86
57	Furniture and Home Furnishings Stores	74	89	79	84	72	191
58	Eating and Drinking Places	3,908	4,641	4,508	4,232	4,646	7,521
59	Miscellaneous Retail	1,955	2,043	1,829	1,568	1,314	2,128
60-67	Finance, Insurance & Real Estate	47	48	39	42	38	81
70	Hotels and Other Lodging Places	120	133	126	96	107	175
72	Personal Services	518	511	467	433	364	518
73	Business Services	268	290	257	247	220	479
75	Auto Repair, Services, and Parking	99	103	90	110	81	258
76	Miscellaneous Repair Services	62	67	54	58	39	138
78	Motion Pictures	52	69	70	55	54	80
79	Amusement & Recreation Services	151	192	175	142	153	258
80	Health Services	27	48	39	42	44	79
82	Educational Services	22	21	14	14	12	26
83	Social Services	8	15	8	6	5	18
86	Membership Organizations	85	84	71	59	68	120
87	Engineering & Management Services	72	75	52	50	41	80
89	Services, Not Elsewhere Classified	10	10	7	7	3	13
99	Other and Not Classified	29	11	13	6	19	70
	Nondisclosable	16	27	16	22	2	10
	Total Reporters	14,557	15,974	14,823	13,539	13,395	20,927

TABLE 2 – LITTER TAX REPORTERS BY YEAR AND INDUSTRY

Table 2 contains a recent history of the number of taxpayers reporting litter tax liability. This table shows the wide range of industries that report the tax, as well as fluctuations in the number of firms that report from year to year. The total number of reporting taxpayers increased dramatically in Calendar 1999 after dropping slightly in 1998. The 20,927 taxpayers reporting litter tax in 1999 constituted a 56 percent increase. Much of this large increase can be attributed to a change in filing requirements adopted by the 1998 Legislature.

Prior to the change in filing requirements, by statute all litter tax reporting was on an annual basis for all taxpayers. The reporting frequency for taxpayers' other taxes to the Department can be monthly, quarterly or annually. Only about 0.4 percent of litter taxable activity was reported by firms that had an annual reporting requirement for other Department of Revenue taxes. It appeared that taxpayers with reporting requirements other than annual could overlook reporting their litter tax, as the litter tax line only appeared on every fourth (quarterly) or twelfth (monthly) return for these taxpayers.

The Legislature recognized this problem and changed the reporting frequency for litter tax so that it coincides with the taxpayer's reporting frequency for other state excise taxes. This change took effect on January 1, 1999. The 56 percent increase in the number of filers in 1999 indicates that this statutory change had an extremely positive effect on litter tax reporting.

TABLE 3 – LITTER TAX LIABILITY BY INDUSTRY

Table 3 gives detailed industry information on litter tax reporters for Calendar Year 1999. It provides a count of litter taxpayers and compares reported litter tax activity by industry groups.

While the majority of litter tax liability is concentrated in a small number of industries, most industries have some activity subject to litter tax. Eating and drinking firms represent the industry with the most litter taxpayers, followed by grocery stores, miscellaneous retail firms and wholesalers of nondurable goods. Wholesalers of nondurable goods, grocery stores, eating and drinking establishments and food processing firms paid over 75 percent of the tax.

The average annual litter tax liability for all firms is approximately \$263 per firm. Many firms owe tax based on their selling activities, but the amount of tax owed tends to be small. Only five industries had an average litter tax liability per firm of more than \$1,000. The industry with the highest average litter tax liability per firm was paper and allied products. Twenty-one of the forty industries in Table 3 had an average annual tax of less than \$100.

Table 3
LITTER TAX LIABILITY BY INDUSTRY
Calendar Year 1999

SIC Group	Industry Description	# Litter Taxpayers	Litter Tax Liability	Average
1-14	Agricultural and Fishing	490	\$52,263	\$107
15-17	Construction	662	14,734	22
20	Food and Kindred Products	235	436,781	1,859
24,25	Lumber, Wood Products and Furniture	33	26,448	801
26	Paper and Allied Products	35	86,409	2,469
27	Printing and Publishing	330	153,426	465
28,29	Chemical and Petroleum Mfg.	17	2,486	146
30	Rubber and Misc. Plastics Products	10	6,542	654
31,32	Leather, Stone Products	10	11,594	1,159
33,34	Primary and Fabricated Metals	16	22,444	1,403
35,36	Industrial and Electrical Machinery	24	7,747	323
37	Transportation Equipment	27	464	17
39	Miscellaneous Manufacturing Industries	20	2,664	133
41-47	Transportation	85	7,280	86
49	Electric, Gas, and Sanitary Services	24	2,095	87
50	Wholesale Trade Durable Goods	332	91,814	277
51	Wholesale Trade Nondurable Goods	1,738	1,641,458	944
52	Building Materials & Garden Supplies	200	14,838	74
53	General Merchandise Stores	190	281,974	1,484
54	Food Stores	3,219	1,585,079	492
55	Automotive Dealers & Service Stations	911	77,366	85
56	Apparel and Accessory Stores	86	13,436	156
57	Furniture and Home Furnishings Stores	191	12,479	65
58	Eating and Drinking Places	7,521	484,466	64
59	Miscellaneous Retail	2,128	267,917	126
60-67	Finance, Insurance & Real Estate	81	5,865	72
70	Hotels and Other Lodging Places	175	13,124	75
72	Personal Services	518	10,206	20
73	Business Services	479	78,282	163
75	Auto Repair, Services, and Parking	258	5,706	22
76	Miscellaneous Repair Services	138	2,006	15
78	Motion Pictures	80	5,043	63
79	Amusement & Recreation Services	258	11,779	46
80	Health Services	79	4,012	51
82	Educational Services	26	1,637	63
83	Social Services	18	404	22
86	Membership Organizations	120	2,092	17
87	Engineering & Management Services	80	61,729	772
89	Services, Not Elsewhere Classified	13	154	12
99	Other and Not Classified	70	2,885	41
Total Reporters		20,927	\$5,509,128	\$263

TABLES 4 AND 5 – ESTIMATED LITTER TAX NONCOMPLIANCE

During the 1990s the Department of Revenue developed a methodology for measuring excise tax noncompliance among registered taxpayers. A representative sample of accounts stratified by size and industry was selected annually. Estimates of overall noncompliance were derived from the results of audits of the sample accounts.

The estimate of litter tax noncompliance reported here is based on the same sampling methodology. Audit results for the annual stratified random sample drawn in 1999 were analyzed and statistically projected to Calendar Year 1999. The results analyzed included audits by Taxpayer Account Administration as well as the Audit Division. As litter tax is concentrated in a few major industry sectors, only four industry categories were used.

Table 4
ESTIMATED NONCOMPLIANCE BY MAJOR INDUSTRY SECTOR
Projected to Calendar Year 1999

<u>Major Industry Sector</u>	<u>Noncompliance Found Through Enforcement</u>	<u>Estimated Undetected Noncompliance</u>	<u>Total Estimated Noncompliance</u>
Manufacturing	\$ 158,693	\$ 867,348	\$1,026,041
Wholesale	\$ 452,547	\$ 495,373	\$ 947,920
Retail	\$ 306,230	\$ 714,396	\$1,020,626
All Other	\$ 98,250	\$ (89,026)	\$ 9,224
Total	\$1,015,720	\$ 1,988,091	\$3,003,811

The resulting estimates are reported in Table 4.

Enforcement activities found slightly over \$1 million in unreported litter tax for Calendar Year 1999. The amount of undetected litter tax liability was estimated at slightly under \$2 million. Estimates of both undetected and total noncompliance were highest for the manufacturing sector. Virtually all noncompliance was projected to be among manufacturing, wholesale and retail firms.

Several considerations need to be stressed when interpreting these results:

- ◆ These estimates are statistical projections of what could be found if an audit was performed on every single firm currently registered and reporting excise tax to the Department of Revenue. For 1999, that encompassed more than 250,000 firms.
- ◆ The majority of undetected noncompliance was projected to be among the smaller firms in the industry sectors. Given the extremely low litter tax rate, the liability amount in many cases would be too small for any attempt at recovery to be cost effective.

- ◆ The noncompliance estimates are based on multi-year audits performed over a period of several years. The results are based on annualized numbers projected to 1999. This offers no insight into changes in noncompliance over time.

Table 5
TOTAL VOLUNTARY REPORTING AND NONCOMPLIANCE
Projected to Calendar Year 1999

	<u>Amount</u>	<u>% of Total</u>
Tax Reported Voluntarily	\$4,493,408	59.9%
Noncompliance Found Through Enforcement	\$1,015,720	13.5%
Estimated Undetected Noncompliance	\$1,988,091	26.5%
 Total Estimated Liability	 \$7,497,219	 100.0%

The rate of noncompliance for litter tax is very high relative to other taxes. As Table 5 indicates, litter tax noncompliance is estimated to be about 40 percent of total liability among registered taxpayers. This is due in part to the complexity of the tax and the fact that total liability for a business is frequently very small. However, it should be noted that the number of taxpayers reporting litter tax for Calendar Year 1999 increased 56 percent and that voluntarily reported litter tax was at an all-time high. This suggests that legislative and administrative simplifications have improved overall litter tax reporting.